

PROSPECTUS

\$40,000,000
AGS Computers, Inc.

7½% CONVERTIBLE SUBORDINATED DEBENTURES DUE 2011

Interest payable April 15 and October 15

Convertible into Common Stock of the Company on or before April 15, 2011, unless previously redeemed, at a conversion price of \$27.30 per share, subject to adjustment in certain events. The last reported sale price of the Company's Common Stock on the New York Stock Exchange on April 17, 1986 was \$21 per share.

The Debentures are not redeemable prior to April 15, 1988, unless the last reported sale price of the Common Stock for at least 20 trading days within a period of 30 consecutive trading days is at least 150% of the conversion price then in effect. The Debentures are redeemable on at least 30 days' notice (a) at the option of the Company, in whole or in part at any time, initially at 107.5%, and at decreasing prices thereafter to and including April 14, 1996, and thereafter at 100%, and (b) through operation of the mandatory sinking fund at 100%, together in each case with accrued interest.

Mandatory annual sinking fund payments, sufficient to retire 5% of the aggregate principal amount of Debentures issued, will be made on each April 15, commencing April 15, 1997, to and including April 15, 2010. These payments are calculated to retire 70% of the issue prior to maturity. The Company has a non-cumulative option to increase any mandatory sinking fund payment by an amount not exceeding an additional 5% of the aggregate principal amount of Debentures issued. The Company may credit against mandatory sinking fund payments Debentures previously acquired, converted or redeemed other than through the mandatory sinking fund.

Application has been made to list the Debentures on the New York Stock Exchange.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

PRICE 100% AND ACCRUED INTEREST

	Price to Public(1)	Underwriting Discounts and Commissions(2)	Proceeds to Company(1)(3)
Per Debenture	100.00%	3.00%	97.00%
Total	\$40,000,000	\$1,200,000	\$38,800,000

(1) Plus accrued interest, if any, from April 28, 1986.

(2) The Company has agreed to indemnify the Underwriter against certain liabilities, including liabilities under the Securities Act of 1933.

(3) Before deduction of estimated expenses of \$230,000 payable by the Company.

The Debentures are offered by the Underwriter, subject to prior sale, when, as and if issued by the Company and accepted by the Underwriter, and subject to approval of certain legal matters by Davis Polk & Wardwell, counsel for the Underwriter, and certain other conditions. It is expected that delivery of the Debentures will be made on or about April 28, 1986 at the office of Morgan Stanley & Co. Incorporated, 55 Water Street, New York, N.Y., against payment therefor in New York funds.

MORGAN STANLEY & CO.
Incorporated

No person is authorized in connection with the offering made hereby to give any information or to make any representation other than as contained or incorporated by reference in this Prospectus and, if given or made, such information or representation must not be relied upon as having been authorized by the Company or the Underwriter. This Prospectus does not constitute an offer to sell or a solicitation of an offer to buy any of the securities offered hereby in any jurisdiction to any person to whom it is unlawful to make such offer or solicitation in such jurisdiction. Neither the delivery of this Prospectus nor any sale made hereunder shall under any circumstances create any implication that the information herein is correct as of any time subsequent to the date hereof.

TABLE OF CONTENTS

	<u>Page</u>		<u>Page</u>
Available Information	2	Business	10
Documents Incorporated by Reference ..	2	Description of Debentures	14
Prospectus Summary	3	Description of Common Stock	18
The Company	4	Underwriting	18
Use of Proceeds	4	Legal Opinions	19
Capitalization	5	Experts	19
Price Range of Common Stock	6	Additional Information	19
Dividend Policy	6	Index to Consolidated Financial	
Selected Financial Data	7	Statements	20
Management's Discussion and Analysis of Results of Operations and Financial Condition	8		

AVAILABLE INFORMATION

The Company is subject to the informational requirements of the Securities Exchange Act of 1934 and in accordance therewith files reports, proxy statements and other information with the Securities and Exchange Commission (the "Commission"). Such documents can be inspected and copied at the public reference facilities at the offices of the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549 and at the Commission's regional offices at Everett McKinley Dirksen Building, 219 South Dearborn Street, Room 1228, Chicago, Illinois 60604, 26 Federal Plaza, New York, New York 10278, and 5757 Wilshire Boulevard, Los Angeles, California 90036. Copies of such material can be obtained from the Public Reference Section of the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549 at prescribed rates. Such documents also may be inspected at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005 and the Pacific Stock Exchange, 618 South Spring Street, Los Angeles, California 90014 and 301 Pine Street, San Francisco, California 94104.

DOCUMENTS INCORPORATED BY REFERENCE

The Company's Annual Report on Form 10-K for the year ended December 31, 1985, previously filed by the Company with the Commission, is incorporated herein by reference.

Any statement contained in a document incorporated by reference shall be deemed to be modified or superseded for purposes of this Prospectus and the related Registration Statement to the extent that a statement contained in this Prospectus modifies or replaces such statement. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Prospectus.

The Company will provide without charge to each person, including any beneficial owner, to whom a copy of this Prospectus is delivered, upon the written or oral request of such person, a copy of the Annual Report on Form 10-K incorporated in this Prospectus by reference (other than exhibits to the Annual Report unless such exhibits are specifically incorporated by reference therein). Written requests or requests by telephone for such copies should be directed to Pearl Turteltaub, Manager, Shareholder Relations, AGS Computers, Inc., 1139 Spruce Drive, Mountainside, New Jersey 07092 (telephone (201) 654-4321).

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITER MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE DEBENTURES OFFERED HEREBY OR THE COMPANY'S COMMON STOCK AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH TRANSACTIONS MAY BE EFFECTED ON THE NEW YORK STOCK EXCHANGE OR PACIFIC STOCK EXCHANGE, IN THE OVER-THE-COUNTER MARKET, OR OTHERWISE. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

PROSPECTUS SUMMARY

This summary is qualified in its entirety by the more detailed information and consolidated financial statements appearing elsewhere in this Prospectus.

THE COMPANY

AGS Computers, Inc. (the "Company") (i) provides professional custom software development services and develops and markets computer software products, and (ii) distributes microcomputer-related hardware. Customers for software development services and software products, include major telecommunications companies, banks and financial institutions and computer manufacturers. The Company distributes microcomputer-related hardware of approximately 20 manufacturers to resellers, including system integrators, original equipment manufacturers and computer stores.

THE OFFERING

The Company is offering \$40,000,000 principal amount of 7½% Convertible Subordinated Debentures Due 2011 (the "Debentures"). Interest payments will be made on April 15 and October 15 of each year, commencing on October 15, 1986. The Debentures are convertible into Common Stock of the Company until maturity, unless previously redeemed, at \$27.30 per share, subject to adjustment. The Debentures are subordinated to all Senior Indebtedness, as defined. Annual sinking fund payments of 5% of the aggregate principal amount of the Debentures issued will be made on each April 15, beginning April 15, 1997 and ending on April 15, 2010. These payments are calculated to retire 70% of the issue prior to maturity. The Debentures are redeemable at any time on or after April 15, 1988 (unless the last reported sale price of the Common Stock shall have equaled or exceeded 150% of the conversion price then in effect for at least 20 trading days within a period of 30 consecutive trading days, in which case redemption may occur earlier) at declining redemption premiums through April 14, 1996, and thereafter at par. Application has been made to list the Debentures on the New York Stock Exchange. See "Description of Debentures".

USE OF PROCEEDS

The Company intends to use the net proceeds to repay outstanding bank borrowings of approximately \$31,250,000. The balance will be used for general business purposes and potential acquisitions. See "Use of Proceeds".

SELECTED FINANCIAL INFORMATION (In thousands, except ratios and per share data)

INCOME STATEMENT DATA:

	Years Ended December 31,				
	1985	1984	1983	1982	1981
Sales	\$279,182	\$221,631	\$145,911	\$65,026	\$38,773
Income from continuing operations	7,493	6,781	5,785	2,484	1,796
Net income	7,493	5,839	5,785	2,484	1,796
Income per share from continuing operations					
Primary	1.43	1.29	1.25	.73	.57
Fully diluted	1.43	1.29	1.20	.73	.57
Net income per share					
Primary	1.43	1.11	1.25	.73	.57
Fully diluted	1.43	1.11	1.20	.73	.57
Weighted average shares outstanding					
Primary	5,253	5,270	4,609	3,419	3,174
Fully diluted	5,253	5,270	5,072	3,419	3,174
Ratio of earnings to fixed charges					
Actual(1)	5.16	4.60	7.79	5.36	8.17
Pro forma(1)	5.63	—	—	—	—

BALANCE SHEET DATA:

	December 31, 1985	
	Actual	As Adjusted(2)
Working capital	\$ 21,374	\$ 44,694
Total assets(3)	111,101	132,851
Total debt	19,465	41,215
Stockholders' equity	49,002	49,002

(1) For purposes of these ratios, income has been calculated by adding fixed charges to income from continuing operations before provision for income taxes and excluding equity in losses of affiliated companies. Fixed charges consist of cost of borrowings and one-third of rental expense. The pro forma ratio of earnings to fixed charges reflects the interest expense on that portion of the Debentures the proceeds of which are to be used to repay outstanding indebtedness and the elimination of interest expense on such outstanding indebtedness.

(2) Adjusted to reflect the sale of the Debentures offered hereby and the anticipated use of the net proceeds to repay bank borrowings.

(3) Total assets include \$30,971,000 of costs in excess of net assets of subsidiaries acquired.

THE COMPANY

AGS Computers, Inc. (i) provides professional custom software development services ("System Development Services") and develops and markets computer software products ("Software Products"), and (ii) distributes microcomputer-related hardware ("Microcomputer Distribution"). System Development Services and Software Products are collectively referred to as "Software". For 1985, the Company's Software business contributed approximately 42% of sales and 64% of gross profits, while Microcomputer Distribution contributed approximately 58% of sales and 36% of gross profits.

System Development Services is a professional services business, which supplies programmers, analysts, project leaders and managers to develop and enhance management information systems, communications systems and operating systems software for its customers. The Company currently employs approximately 1,300 professionals, who may be assigned to work under client supervision or on a team where the Company has total project responsibility. The Company's Software Products are used for banking and communications applications and the management of complex engineering and data processing projects. Customers for the Company's System Development Services and Software Products include major telecommunications companies, banks and financial institutions and computer manufacturers.

In its Microcomputer Distribution business, the Company sells peripherals and microcomputers of approximately 20 manufacturers to resellers, including system integrators, original equipment manufacturers and computer stores from its 11 distribution facilities located throughout the United States. The largest suppliers for the Company's Microcomputer Distribution business in 1985 were Okidata, Hayes Microcomputer Products, Inc., Altos Computer Systems, Princeton Graphics Systems and AST Research Inc. The Company believes that it is the largest independent distributor of microcomputer-related hardware in the United States.

The Company was incorporated in New York in 1967. The Company's principal executive office is located at 1139 Spruce Drive, Mountainside, New Jersey 07092, and its telephone number is (201) 654-4321. Unless the context otherwise indicates, all references in this Prospectus to the "Company" include AGS Computers, Inc. and its subsidiaries.

USE OF PROCEEDS

The estimated net proceeds of the offering by the Company will be \$38,570,000. The Company intends to use such net proceeds to repay outstanding bank borrowings of approximately \$31,250,000, bearing interest at the prime rate and which were incurred principally in connection with acquisitions. The balance will be used for general business purposes and potential acquisitions. While the Company is continually exploring possible acquisitions, it currently has no understandings or agreements with any other party except for a letter of intent to acquire Genasys Corporation. See "Business—Acquisitions". Until used for the foregoing purposes, the net proceeds of this offering will be invested for the short term in marketable securities.

CAPITALIZATION

The following table sets forth the capitalization of the Company as of December 31, 1985 and as adjusted to give effect to the sale of the Debentures offered hereby and the use of the net proceeds thereof. See "Use of Proceeds".

	December 31, 1985	
	Actual	As Adjusted
	(In thousands)	
SHORT-TERM DEBT:		
Bank credit facility	\$ 3,000 (1)	
Other notes payable	<u>1,182</u>	<u>\$ 1,182</u>
Total short-term debt	<u>\$ 4,182</u>	<u>\$ 1,182</u>
LONG-TERM DEBT:		
Bank credit facility	\$28,250 (1)	
Other notes payable	33	\$ 33
7½% Convertible Subordinated Debentures due 2011		40,000
DEFERRED INCOME TAXES (currently payable \$10,949,000)	13,585	13,585
STOCKHOLDERS' EQUITY:		
Common stock, par value \$.10 per share, authorized 25,000,000 shares; issued 5,311,000	531	531
Paid-in capital	23,347	23,347
Retained earnings	25,964	25,964
Less 54,000 shares of treasury stock at cost	<u>(840)</u>	<u>(840)</u>
Total stockholders' equity	<u>49,002</u>	<u>49,002</u>
Total capitalization	<u>\$90,870</u>	<u>\$102,620</u>

(1) Reflects amount outstanding at March 31, 1986.

PRICE RANGE OF COMMON STOCK

The Company's Common Stock is listed on the New York Stock Exchange and Pacific Stock Exchange. Prior to October 18, 1984, the Common Stock was traded in the over-the-counter market with last sale prices being reported on the NASDAQ National Market System.

The following table sets forth the quarterly high and low last sale prices for the Common Stock reported on the NASDAQ National Market System through October 17, 1984 and the quarterly high and low prices on the New York Stock Exchange thereafter:

	<u>High</u>	<u>Low</u>
1984		
First Quarter	\$ 30½	\$ 19¾
Second Quarter	20¼	15
Third Quarter	16¾	9¾
Fourth Quarter	13½	9¾
1985		
First Quarter	17¾	12¼
Second Quarter	15¼	10¼
Third Quarter	17	14¾
Fourth Quarter	23½	13¾
1986		
First Quarter	25¾	19¾
Second Quarter (through April 17)	23	20

On April 17, 1986, the last reported sale price of the Company's Common Stock on the New York Stock Exchange was \$21.

DIVIDEND POLICY

The Company has not paid cash dividends on its Common Stock since 1972. The present policy of the Board of Directors is to retain earnings to provide funds for the operation and expansion of the Company's business. Accordingly, it is anticipated that no cash dividends will be paid to holders of Common Stock in the foreseeable future. The payment of cash dividends is prohibited under its bank credit facility. See Note D to the Consolidated Financial Statements.

SELECTED FINANCIAL DATA

Set forth below are selected financial data derived from the consolidated statements of income of the Company for each of the five years ended December 31, 1985 and the consolidated balance sheets of the Company at December 31 in each of the five years then ended. The selected financial data insofar as it relates to each of the three years in the period ended December 31, 1985, which have been reported on by Coopers & Lybrand, are derived from the financial statements included elsewhere herein and are qualified by reference to such financial statements. See Note K to the Consolidated Financial Statements for information relating to acquisitions during the three years ended December 31, 1985.

Income Statement Data:

(in thousands, except for ratios and per share data)

	Years Ended December 31,				
	1985	1984	1983	1982	1981
SALES:					
Software	\$117,375	\$ 97,177	\$ 53,773	\$37,203	\$25,701
Microcomputer distribution	161,496	124,055	91,515	27,493	12,911
Interest income	311	399	623	330	161
	<u>279,182</u>	<u>221,631</u>	<u>145,911</u>	<u>65,026</u>	<u>38,773</u>
COST OF SALES:					
Software	77,710	64,382	31,937	24,365	15,873
Microcomputer distribution	138,941	106,429	78,008	22,845	10,691
	<u>216,651</u>	<u>170,811</u>	<u>109,945</u>	<u>47,210</u>	<u>26,564</u>
Selling, general and administrative expenses	45,103	34,593	24,133	12,220	8,507
Interest expense	2,300	2,832	983	762	319
	<u>264,054</u>	<u>208,236</u>	<u>135,061</u>	<u>60,192</u>	<u>35,390</u>
Income from continuing operations before income taxes ...	15,128	13,395	10,850	4,834	3,383
Income taxes	7,635	6,614	5,065	2,350	1,587
Income from continuing operations	7,493	6,781	5,785	2,484	1,796
Discontinued operations:					
Loss from discontinued operations (less applicable income taxes of \$417)		(483)			
Loss on disposal of discontinued operations (less applicable income taxes of \$391)		(459)			
Loss from discontinued operations		(942)			
Net income	<u>\$ 7,493</u>	<u>\$ 5,839</u>	<u>\$ 5,785</u>	<u>\$ 2,484</u>	<u>\$ 1,796</u>
INCOME PER SHARE FROM CONTINUING OPERATIONS:					
Primary	\$ 1.43	\$ 1.29	\$ 1.25	\$.73	\$.57
Fully diluted	1.43	1.29	1.20	.73	.57
(LOSS) PER SHARE FROM DISCONTINUED OPERATIONS:					
Primary		\$ (.18)			
NET INCOME PER SHARE:					
Primary	\$ 1.43	\$ 1.11	\$ 1.25	\$.73	\$.57
Fully diluted	1.43	1.11	1.20	.73	.57
WEIGHTED AVERAGE SHARES OUTSTANDING:					
Primary	5,253	5,270	4,609	3,419	3,174
Fully diluted	5,253	5,270	5,072	3,419	3,174
Ratio of Earnings to Fixed Charges:					
Actual(1)	5.16	4.60	7.79	5.36	8.17
Pro forma(1)	5.63	—	—	—	—

Balance Sheet Data:

(in thousands)

	December 31,				
	1985	1984	1983	1982	1981
Working capital	\$ 21,374	\$ 13,694	\$ 10,064	\$10,681	\$ 2,518
Total assets(2)	111,101	93,259	68,853	33,800	15,042
Total debt	19,465	19,193	11,045	11,070	1,445
Stockholders' equity	49,002	42,017	35,222	10,059	5,416

(1) For purposes of these unaudited ratios, income has been calculated by adding fixed charges to income from continuing operations before provision for income taxes and excluding equity in losses of affiliated companies. Fixed charges consist of cost of borrowings and one-third of rental expense. The unaudited pro forma ratio of earnings to fixed charges reflects the interest expense on that portion of the Debentures, the proceeds of which are to be used to repay outstanding indebtedness and the elimination of interest expense on such outstanding indebtedness.

(2) For the years 1985, 1984, 1983, 1982 and 1981 total assets include \$30,971,000, \$28,631,000, \$16,376,000, \$6,578,000 and \$2,446,000, respectively, of costs in excess of net assets of subsidiaries acquired.

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION**

The following table sets forth for the periods indicated the percentages which certain income and expense items bear to sales and the percentage increase (decrease) of such items as compared to the prior year:

	Percentage of Sales			Period to Period Increase (Decrease)	
	For the years ended December 31,			1985 compared to 1984	1984 compared to 1983
	1985	1984	1983		
SALES:					
Software	42.0%	43.8%	36.9%	20.8%	80.7%
Microcomputer Distribution	57.9	56.0	62.7	30.2	35.6
Interest income .....	.1	.2	.4	(22.1)	(36.0)
Total sales	100.0	100.0	100.0	26.0	51.9
COST OF SALES:					
Software	27.8	29.1	21.9	20.7	101.6
Microcomputer Distribution	49.8	48.0	53.5	30.5	36.4
Total costs	77.6	77.1	75.4	26.8	55.4
Selling, general and administrative expenses	16.2	15.6	16.5	30.4	43.3
Interest expense .....	.8	1.3	.7	(18.8)	188.1
Total costs and expenses	94.6	94.0	92.6	26.8	54.2
Income from continuing operations before income taxes	5.4	6.0	7.4	12.9	23.5
Income taxes	2.7	3.0	3.4	15.4	30.6
Net income from continuing operations	2.7	3.0	4.0	10.5	17.2
Loss from discontinued operation	—	.4	—	—	—
Net income	2.7%	2.6%	4.0%	28.3%	.9%

Sales

The Company's Software sales increased 20.8% in 1985 and 80.7% in 1984 from prior periods. Acquisitions accounted for approximately 4% and 49% of the sales growth in those periods, respectively. The balance of the increase was mainly attributable to growth in System Development Services requiring additional billable staff, and to a lesser extent, to price increases for those services. Microcomputer Distribution sales increased 30.2% and 35.6% in 1985 and 1984, respectively, due to broad-based, industry-wide demand and the expansion of the geographic territory covered.

Cost of Sales

Cost of Software sales were 66.2%, 66.3% and 59.4% of Software sales in 1985, 1984 and 1983, respectively. Lower percentage costs in 1983 were principally due to the demand for a software product which had a high gross margin. Cost of Software sales as a percentage of Software sales remained relatively constant in 1985 as compared to 1984. Although there were higher salary costs in System Development Services in 1985 which were not matched by increased customer charges, there was an offsetting increase in the sales of Software Products that have higher margins than System Development Services. Cost of Software sales were also affected by start-up costs of \$911,000 in 1985 and \$408,000 in 1984 relating to a product that was discontinued. Microcomputer Distribution's cost of sales as a percentage of Microcomputer Distribution sales increased from 85.2% in 1983 to 85.7% in 1984 and to 86.0% in 1985. However, the operating profits in Microcomputer Distribution as a percentage of sales stayed relatively stable over the three-year period due to a slower rate of increase in selling, general and administrative expenses. See Note N to the Consolidated Financial Statements.

Selling, General and Administrative Expenses

Selling, general and administrative expenses declined as a percentage of sales from 16.5% in 1983 to 15.6% in 1984 because of economies of scale, although the expenses increased by approximately \$10,500,000 primarily due to an acquisition. Selling, general and administrative expenses increased as a percentage of sales from 15.6% in 1984 to 16.2% in 1985 primarily due to the writedown of the Company's two equity investments in micro software publishing. Selling, general and administrative expenses include the amortization of acquisition-related "goodwill". Management believes that the amortization of these assets without recognition of new assets which replace these values understates the Company's assets.

Income Taxes

The income tax rate has fluctuated between 47% and 50% over the last three years. During 1983 through 1985, amounts accrued for income taxes have exceeded actual tax payments. The difference between tax accruals and payments is primarily due to the Company's use of the cash basis to report its Software area for tax purposes while using the accrual method for financial reporting purposes. The effect on deferred taxes from reporting of income on the cash basis for income tax purposes was \$1,730,000, \$1,196,000 and \$1,662,000 in 1985, 1984 and 1983, respectively.

Net Income

Net income for 1985 of \$7,493,000 represented an increase of 28.3% over net income for 1984. In 1984, net income was reduced by \$942,000 resulting from the discontinuation of a software-only distribution business. Income from continuing operations for the year ended December 31, 1985 increased by 10.5% over 1984.

Consolidated net income reflects the varying contribution of System Development Services, Microcomputer Distribution and Software Products to the sales mix as well as start-up costs in new business areas, the amortization of acquisition-related "goodwill" and interest costs which are associated with acquisitions.

Liquidity and Capital Resources

Working capital requirements for the Company's internal growth and operations have been satisfied principally from funds generated from operations. To date, the Company's seasonal needs and funds for acquisitions have been obtained from bank borrowings. After application of the net proceeds of this offering to repay outstanding bank debt, the Company will have a \$20,000,000 revolving line of credit available. The Company is considering a reduction in the amount available under that facility. Based on its present operating plan, the Company anticipates that funds generated from operations together with bank borrowings will be sufficient to meet its cash needs. The Company's business has not been materially affected by inflation.

Recent Developments

Management believes that net income for the first quarter of 1986 will not compare favorably with the corresponding period of 1985. This decline is primarily due to pressure on operating margins in Microcomputer Distribution from increased competition, lower sales of certain software products and an increase in selling, general and administrative expenses.

The Company recently completed its acquisition of the microcomputer hardware and software distribution business of Compuserve, a Canadian distributor. Compuserve will be included in the Company's first quarter operating results. See Note O to the Consolidated Financial Statements.

BUSINESS

The Company (i) provides professional custom software development services ("System Development Services") and develops and markets computer software products ("Software Products"), and (ii) distributes microcomputer-related hardware ("Microcomputer Distribution"). The following table sets forth the Company's sales and gross profits for each of the five years ended December 31, 1985.

	Years ended December 31,				
	1985	1984	1983	1982	1981
	(In thousands)				
SALES:					
Software					
System Development Services	\$ 95,622	\$ 79,173	\$ 36,892	\$30,243	\$20,876
Software Products	21,753	18,004	16,881	6,960	4,825
Total Software	117,375	97,177	53,773	37,203	25,701
Microcomputer Distribution	161,496	124,055	91,515	27,493	12,911
Total sales	\$278,871	\$221,232	\$145,288	\$64,696	\$38,612
GROSS PROFIT:					
Software	\$ 39,665	\$ 32,795	\$ 21,836	\$12,838	\$ 9,828
Microcomputer Distribution	22,555	17,626	13,507	4,648	2,220
Total gross profit	\$ 62,220	\$ 50,421	\$ 35,343	\$17,486	\$12,048

Software

The Company's Software business consists of System Development Services and the development and marketing of Software Products.

System Development Services

System Development Services is a professional services business, which supplies programmers, analysts, project leaders and managers to develop and enhance management information systems, communications systems and operating systems software for its customers. The Company currently employs approximately 1,300 professionals who may be assigned to work under client supervision or on a team where the Company has total project responsibility. The Company's strategy is to leverage its technical and marketing skills to provide its customers with an overall automation solution. While most of the Company's clients have large professional staffs, the Company believes that clients utilize its services to obtain faster, more efficient service and to obtain additional technical skills or expertise which are not readily available in a timely fashion or which do not justify permanent staff increases. The Company provides its System Development Services to its customers for specific projects or needs on a contract basis. The contracts generally bill on the basis of time supplied and are cancellable on 30 days' notice.

Clients for the Company's System Development Services include major telecommunications companies, banks and financial institutions and computer manufacturers. American Telephone & Telegraph Company ("AT&T") has been a client since 1970. See "Major Customers".

As a result of its long client association with AT&T and affiliates, the Company has developed a large consulting staff experienced in UNIX®. UNIX®, which was developed by Bell Telephone Laboratories, Inc. is one of the major computer operating systems. Over 100 computer companies have introduced UNIX® or UNIX®-comparable operating systems. UNIX® is used primarily in a multi-user environment for both business and engineering applications.

UNIX® is a registered trademark of Bell Telephone Laboratories, Inc.

Software Products

The Company develops, markets and maintains software for project management/system development, banking and communications applications. The Company's Software Products are compatible with most mainframe computers and many minicomputers.

The Company generally licenses its Software Products indefinitely for fees ranging from \$10,000 to \$250,000. Maintenance is provided for an initial period, after which the licensee may agree to a maintenance plan for an additional fee. Maintenance consists of resolving problems in the installed product, providing enhancements and offering continuous technical advice concerning the use of the product.

Project Management Systems

The Company designs and markets project management and system development products for monitoring the planning and control of complex projects. These products provide simulation, scheduling, resource allocation, network evaluation and target scheduling. The Company's products help reduce the cost of projects and assure their timely implementation. The Company has entered into approximately 2,000 licenses of its Software Products for project management and system development methodology.

Banking Applications

The Company's banking applications products, which are used by over 500 banks and savings and loan associations, handle specialized applications. The products include:

Account Reconciliation, which handles the reconciliation of multiple customer accounts.

Cash Disbursement Float Management, which is a money management tool for maximizing utilization of available cash.

Combined Interest Reporting System, which generates IRS Forms 1099 and 1087, and handles reporting functions.

Retirement Reporting System, which handles IRA/Keogh reporting.

Travelers Cheque, which handles VISA Travelers Cheque processing.

Federal Reserve/Correspondent Bank Reconciliation, which tracks, reports and reconciles funds transfers.

Time Deposit System, which performs time deposit accounting.

Communication Applications

The Company provides software products that permit non-IBM hardware to communicate with IBM mainframe computers using industry-standard protocols. By permitting small systems to communicate and operate as if they were remote IBM terminals, the Company's software allows its clients, which include major computer and peripheral manufacturers, to efficiently tie their systems to IBM systems. Peer to peer as well as host/slave communications are supported by the Company's products. These products are all written in the "C" programming language which makes it easier to transport this software to UNIX® and non-UNIX® operating systems.

Major Customers

AT&T and affiliates, the Company's largest client, accounted for approximately 25% of the Company's Software sales in 1985. At the end of 1985, the Company was engaged in over 70 projects for AT&T and affiliates. The loss of AT&T and affiliates, which has been a client of the Company since 1970, would have an adverse effect in this area of the Company's business.

Microcomputer Distribution

The Company believes that it is the largest independent distributor of microcomputer-related hardware in the United States. The Company only distributes to resellers which include system integrators, original equipment manufacturers and computer stores. Peripheral equipment accounts for approximately 85% of the Company's sales in this segment, with microcomputers accounting for approximately 15%.

The Company obtains products from approximately 20 suppliers. The five largest suppliers in 1985—Okidata, Hayes Microcomputer Products, Inc., Altos Computer Systems, Princeton Graphics Systems and AST Research Inc.—represented approximately 67% of the Company's Microcomputer Distribution sales. Contracts with suppliers are non-exclusive, generally for one year and cancellable on 30 days' notice.

The Company's strategy in its distribution business is based upon offering quality products together with a high level of service and dealer support. The Company selects products only after extensive evaluation of user features, availability, reliability, serviceability and the financial condition of the manufacturer and seeks to market products which offer the best possible price/performance characteristics. A critical aspect of the Company's competitiveness is its ability to anticipate demand and deliver these products quickly and in sufficient quantity. To meet this requirement, the Company maintains in-depth inventory at each of its 11 distribution facilities located throughout the United States. The Company attempts to fill orders within 24 hours of receipt. In addition, the Company provides its customers with substantial sales and marketing support services, on-site demonstrations, product updates and sales seminars, as well as technical and service support and information hotlines. By maintaining close relationships with its product suppliers, the Company is able to provide its customers with a continuous flow of information concerning new products and technical developments. To minimize customer costs for carrying inventory, the Company has developed floor planning arrangements with several major finance companies which feature no finance charges for 30 days. Sales are also made for cash or on credit terms generally not in excess of 30 days.

The Company recently completed its acquisition of the microcomputer hardware and software distribution business of Compuserve, a Canadian distributor with 1985 revenues of approximately \$30,000,000. Compuserve will be included in the Company's first quarter operating results. See Note O to the Consolidated Financial Statements.

Acquisitions

The Company has an active acquisition program which is based upon the following strategy; the Company believes that purchasing an existing computer services or related business is often more cost effective than incurring the large start-up expenses and long lead time associated with opening and staffing new operations. In addition, the Company has sought to acquire businesses in new geographical areas and those that offer complementary services or product lines in order to provide customers a broader range of capabilities to satisfy their software development requirements.

The Company has entered into a letter of intent to acquire Genasys Corporation ("Genasys"), a system development services company that services government and business organizations. Genasys had 1985 revenues of approximately \$8,000,000. The acquisition is subject to, among other things, the delivery of a definitive agreement and the completion of the Company's due diligence review.

Information concerning acquisitions made by the Company during 1983, 1984 and 1985 is contained in Note K to the Consolidated Financial Statements.

Marketing

System Development Services and Software Products are marketed by a staff of approximately 120 sales people through offices in 38 cities in the United States and 3 international locations. In addition, the Company's professional staff is often involved in marketing System Development Services.

Microcomputer products are marketed by a staff of approximately 100 sales and marketing support services people located in 11 distribution centers throughout the United States.

Product Development

Substantially all the Company's research and development activities are devoted to the development of Software Products. Rapid technological change in the computer industry requires the Company to make continual expenditures for development and improvement of its Software Products. To the extent that the Company fails to achieve technological advances comparable to those made by others in the computer industry, its products may become obsolete. Information concerning research and development costs is contained in Note A to the Consolidated Financial Statements.

Product Protection

Under existing law, software products have been difficult to patent, and copyright laws offer only limited protection. However, the Company treats its software products as proprietary and relies upon trade secret laws and internal nondisclosure safeguards, as well as restrictions incorporated in its software products license agreements. Notwithstanding those restrictions, it may be possible for competitors of the Company to copy aspects of its products. The Company believes that, because of the rapid pace of technological change in the computer industry, patent or copyright protection is of less significance than factors such as the knowledge and experience of the Company's management and personnel and their ability to acquire, develop, enhance and market new systems and products. To date, the Company has had no indication of any breaches of the security of its products.

Competition

The businesses in which the Company engages are highly competitive. There are a large number of companies that compete with the Company in each of its businesses; some have substantially greater financial resources, and some of which, while smaller than the Company, are more specialized.

In System Development Services, the Company competes primarily with potential customers' own in-house data processing departments, both in the development and enhancement of systems. Competition also comes from the major accounting firms, independent software companies, consulting firms and independent consultants. Potential competitors include computer manufacturers, which have the resources and technical ability to market software and services similar to those offered by the Company. In this area, the Company competes primarily on the basis of the quality of its work, the specific technical skills it offers, the productivity and availability of its personnel and price.

In the Software Products area, the Company competes with computer hardware companies, other software companies and companies in other fields, such as consulting and accounting firms. In this area, the Company competes on the basis of its expertise, the quality of its products, its maintenance services and price.

In Microcomputer Distribution, the Company competes with other independent distributors. In addition, there are a number of computer manufacturers, including Apple Computer Inc., IBM and Tandy Corp., which sell their own microcomputer systems directly to retailers or to end users and which have greater resources and broader distribution capabilities than the Company. Potential competitors in the distribution and sale of microcomputer-related hardware include manufacturers who do not currently distribute their own products, including some of those who distribute their products through the Company. In this area, the Company competes primarily on the basis of price, its ability to provide a wide range of products to its customers without delay and its reputation and expertise.

Employees

On December 31, 1985, the Company employed over 2,300 employees and consultants. The Company believes that its success has been due in large part to the high quality of its professional

personnel and that its continued success, especially in Software, is heavily dependent upon the Company's ability to continue to attract and retain highly qualified individuals. There is intense competition for the limited number of qualified personnel, and the Company's business will be adversely affected if a sufficient number of qualified employees are not retained. Due to the shortage of personnel with the training and experience required by the Company and its competitors, the Company has in recent years experienced a turnover rate of approximately 30% and has incurred significant recruiting costs. The Company's competitors for such personnel include not only other companies supplying computer-related professional services, but also companies that do such work in-house. The Company historically has been able to recruit and retain sufficient qualified personnel and believes that its recruiting, training and employee relations programs will permit it to continue to attract and retain qualified personnel. The Company believes that its employee relations are satisfactory. No employees are covered by a collective bargaining agreement or are represented by a labor union.

DESCRIPTION OF DEBENTURES

The Debentures will be issued under an Indenture (the "Indenture") to be dated as of April 15, 1986 between the Company and First Fidelity Bank, National Association, New Jersey, as Trustee (the "Trustee"). The Debentures will represent unsecured general obligations of the Company, subordinate in right of payment to certain other obligations of the Company as described under "Subordination of Debentures," and convertible into Common Stock as described under "Conversion of Debentures." The Debentures will be limited to \$40,000,000 principal amount, will be issued in fully registered form only in denominations of \$1,000 or any integral multiple thereof, will bear interest from April 28, 1986 and will mature on April 15, 2011. Application has been made to list the Debentures on the New York Stock Exchange.

The following statements are subject to the detailed provisions of the Indenture and are qualified in their entirety by reference to the Indenture, a copy of which is filed as an exhibit to the Registration Statement and is also available for inspection at the office of the Trustee. References in italics are to the Indenture. Wherever particular provisions of the Indenture are referred to, such provisions are incorporated by reference as a part of the statements made, and the statements are qualified in their entirety by such reference.

Interest at the annual rate set forth on the cover page hereof is payable semiannually on April 15 and October 15, commencing October 15, 1986, to holders of record at the close of business on the preceding April 1 and October 1 respectively, and, unless other arrangements are made, will be paid by check mailed to such holders. (*Section 2.03*)

Principal and premium, if any, will be payable, and the Debentures may be presented for conversion, registration of transfer and exchange, without service charge, at offices in New York, New York and Newark, New Jersey. (*Sections 2.05 and 15.02*)

Conversion of Debentures

The holders of Debentures will be entitled at any time prior to the close of business on April 15, 2011, subject to prior redemption, to convert the Debentures or portions thereof (in denominations of \$1,000 or integral multiples thereof) into Common Stock of the Company, at the conversion price set forth on the cover page of this Prospectus, subject to adjustment as described below. (*Sections 15.01 and 15.04*) Except as described below, no adjustment will be made on conversion of any Debenture for interest accrued thereon or for dividends on any Common Stock issued. (*Section 15.02*) If any Debenture not called for redemption is converted between a record date for the payment of interest and the next succeeding interest payment date, such Debenture must be accompanied by funds equal to the interest payable on such succeeding interest payment date on the principal amount so converted. (*Section 15.02*) The Company is not required to issue fractional interests of Common Stock upon conversion of Debentures and, in lieu thereof, will pay a cash adjustment based upon the market price of the Common Stock on the last business day prior to the date of conversion. (*Section 15.03*) In the

case of Debentures called for redemption, conversion rights will expire at the close of business on the redemption date. (Section 15.01)

The conversion price is subject to adjustment under formulas as set forth in the Indenture in certain events, including: the issuance of Common Stock of the Company as a dividend or distribution on the Common Stock; subdivisions and combinations of the Common Stock; the issuance to all holders of Common Stock of certain rights or warrants entitling them to subscribe for or purchase Common Stock at less than the current market price (as defined); and the distribution to all holders of Common Stock of capital stock (other than Common Stock), or evidences of indebtedness of the Company or of assets (excluding cash dividends or distributions from retained earnings) or rights or warrants to subscribe for or purchase any of its securities (excluding those referred to in this sentence). No adjustment in the conversion price will be required unless such adjustment would require a change of at least 1% in the conversion price then in effect; provided that any adjustment that would otherwise be required to be made shall be carried forward and taken into account in any subsequent adjustment. The Company reserves the right to make such reduction in the conversion price in addition to those required in the foregoing provisions as the Company in its discretion shall determine to be advisable in order that certain stock-related distributions hereafter made by the Company to its stockholders shall not be taxable. (Section 15.05) Except as stated above, the conversion price will not be adjusted for the issuance of Common Stock or any securities convertible into or exchangeable for Common Stock, or carrying the right to purchase any of the foregoing.

In the case of a consolidation or merger involving the Company as a result of which holders of Common Stock shall be entitled to receive stock, securities, other property or assets (including cash) with respect to or in exchange for such Common Stock or in the case of a sale or conveyance to another corporation of the property and assets of the Company as an entirety or substantially as an entirety, the holders of the Debentures then outstanding will be entitled thereafter to convert such Debentures into the kind and amount of shares of stock, other securities or other property or assets which they would have owned or been entitled to receive upon such consolidation, merger, sale or conveyance had such Debentures been converted immediately prior to such consolidation, merger, sale or conveyance. (Section 15.06)

In the event of a taxable distribution to holders of Common Stock which results in an adjustment of the conversion price, the holders of Debentures may, in certain circumstances, be deemed to have received a distribution subject to United States income tax as a dividend; in certain other circumstances, the absence of such an adjustment may result in a taxable dividend to the holders of Common Stock.

Optional Redemption

The Debentures will be redeemable on at least 30 and not more than 60 days' notice, at the option of the Company, as a whole or in part, at any time, at the following prices (expressed as percentages of the principal amount), together with accrued interest to the date fixed for redemption:

If redeemed during the 12-month period beginning April 15:

<u>Year</u>	<u>Percentage</u>	<u>Year</u>	<u>Percentage</u>
1986	107.50%	1991	103.75%
1987	106.75%	1992	103.00%
1988	106.00%	1993	102.25%
1989	105.25%	1994	101.50%
1990	104.50%	1995	100.75%

and 100% if redeemed on or after April 15, 1996; provided, however, that the Debentures may not be redeemed prior to April 15, 1988 unless the last reported sales price of the Company's Common Stock equals or exceeds 150% of the then effective conversion price (as described above) for at least 20

trading days within a period of 30 consecutive trading days ending within five days of the date on which the notice of redemption is first mailed. *(Section 3.01)*

Sinking Fund

The Indenture will provide that, as a sinking fund, the Company will pay to the Trustee before April 15, in each of the years from 1997 to 2010, inclusive, an amount in cash sufficient to redeem 5% of the aggregate principal amount of the Debentures issued. The sinking fund redemption price is 100% of the principal amount of Debentures being redeemed, together with interest accrued to the date fixed for redemption. The Company may also, at its option, provide for the redemption of up to an additional 5% of the aggregate principal amount of Debentures issued through the operation of the sinking fund on each sinking fund redemption date, such optional right being noncumulative. The Company has reserved the right to deliver Debentures to the Trustee or to credit Debentures redeemed (otherwise than through operation of the mandatory sinking fund) or converted (other than Debentures surrendered for conversion that had been called for redemption by application of a mandatory sinking fund payment) or previously delivered to the Trustee for cancellation, at the sinking fund redemption price, in lieu of making all or any part of such mandatory sinking fund payment in cash. The amount of any sinking fund payment in any year shall automatically be reduced by the sinking fund redemption price of any Debentures called for redemption through operation of the sinking fund and converted into Common Stock on or before the date fixed for redemption. Subject to a right of carryover if the amount in the sinking fund in any year is less than \$100,000, the Indenture will provide that the Trustee will apply cash sinking fund payments to the redemption of Debentures on each such April 15. *(Section 3.04)*

Subordination of Debentures

The indebtedness evidenced by the Debentures is subordinate to the prior payment in full of all Senior Indebtedness (as defined below). During the continuance beyond any applicable grace period of any default in the payment of principal, premium, interest or any other payment due on any Senior Indebtedness, no payment of principal of, or premium, if any, or interest on the Debentures shall be made by the Company. In addition, upon any distribution of assets of the Company upon any dissolution, winding up, liquidation or reorganization, the payment of the principal of, or premium, if any, and interest on the Debentures is to be subordinated to the extent provided in the Indenture in right of payment to the prior payment in full of all Senior Indebtedness. *(Article Four)* By reason of such subordination, in the event of the Company's dissolution, holders of Senior Indebtedness may receive more, ratably, and holders of the Debentures may receive less, ratably, than the other creditors of the Company. Such subordination will not prevent the occurrence of any Event of Default under the Indenture.

The term "Senior Indebtedness" means the principal of, premium, if any, interest on, and any other payment due pursuant to any of the following, whether outstanding on the date of the Indenture or thereafter incurred or created:

- (a) all indebtedness of the Company for money borrowed (including any indebtedness secured by a mortgage or other lien which is (i) given to secure all or part of the purchase price of property subject thereto, whether given to the vendor of such property or to another, or (ii) existing on property at the time of acquisition thereof);
- (b) all indebtedness of the Company evidenced by notes, debentures, bonds or other securities sold by the Company for money;
- (c) all lease obligations of the Company which are capitalized on the books of the Company in accordance with generally accepted accounting principles;
- (d) all indebtedness of others of the kinds described in either of the preceding clauses (a) or (b) and all lease obligations of others of the kind described in the preceding clause (c) assumed by

or guaranteed in any manner by the Company or in effect guaranteed by the Company through an agreement to purchase, contingent or otherwise; and

(e) all renewals, extensions or refundings of indebtedness of the kinds described in any of the preceding clauses (a), (b) or (d) and all renewals or extensions of leases of the kinds described in either of the preceding clauses (c) or (d);

unless, in the case of any particular indebtedness, lease, renewal, extension or refunding, the instrument or lease creating or evidencing the same or the assumption or guarantee of the same expressly provides that such indebtedness, lease, renewal, extension or refunding is subordinate to any other indebtedness of the Company or that such indebtedness, lease, renewal, extension or refunding is not superior in right of payment to the Debentures. *(Section 1.01)*

As of March 31, 1986, the Company had approximately \$32,400,000 of debt obligations and capital leases which would constitute Senior Indebtedness. The amount of Senior Indebtedness may change in the future. The Indenture contains no limitations on the incurrence of Senior Indebtedness.

Events of Default and Remedies

An Event of Default will be defined in the Indenture as being: default in payment of the principal of and premium, if any, on any of the Debentures; default in payment of any sinking fund installments; default for 30 days in payment of any installment of interest on the Debentures; default by the Company for 45 days after written notice in the observance or performance of any other covenant in the Indenture; or certain events involving bankruptcy, insolvency or reorganization of the Company. *(Section 7.01)* The Indenture will provide that the Trustee may withhold notice to the holders of Debentures of any default (except in payment of principal, or premium, if any, or interest on, or any sinking fund installment with respect to, the Debentures) if the Trustee considers it in the interest of the holders of the Debentures to do so. *(Section 7.08)*

The Indenture will provide that if an Event of Default shall have occurred and be continuing the Trustee or the holders of not less than 25% in principal amount of the Debentures then outstanding may declare the principal of all the Debentures to be due and payable immediately, but if the Company shall cure all defaults (except the nonpayment of interest and premium, if any, on and principal of any Debentures which shall have become due by acceleration) and certain other conditions are met, such declaration may be annulled and past defaults may be waived by the holders of a majority in principal amount of the Debentures then outstanding. *(Section 7.01)*

The holders of a majority in principal amount of the Debentures then outstanding shall have the right to direct the time, method and place of conducting any proceedings for any remedy available to the Trustee subject to certain limitations specified in the Indenture. *(Section 7.07)*

Modification of the Indenture

The Indenture contains provisions permitting the Company and the Trustee, with the consent of the holders of not less than 66 $\frac{2}{3}$ % in principal amount of the Debentures at the time outstanding, to modify the Indenture or any supplemental indenture or the rights of the holders of the Debentures, except that no such modification shall (i) extend the fixed maturity of any Debenture, reduce the rate or extend the time of payment of interest thereon, reduce the principal amount thereof or redemption premium thereon, impair or affect the right of a holder to institute suit for the payment thereof, change the currency in which the Debentures are payable or impair the right to convert the Debentures into Common Stock subject to the terms set forth in the Indenture, without the consent of the holder of each Debenture so affected, or (ii) reduce the aforesaid percentage of Debentures, the consent of the holders of which is required for any such modification, without the consent of the holders of all of the Debentures. *(Section 11.02)*

Concerning the Trustee

The Trustee is a major lender to the Company and provides other banking services to the Company in the ordinary course of its business.

DESCRIPTION OF COMMON STOCK

The authorized capital stock of the Company consists of 25,000,000 shares of Common Stock, \$.10 par value. As of March 24, 1986, there were 5,277,860 shares of Common Stock outstanding, held of record by approximately 1,100 stockholders. The Company believes that there were approximately 6,000 beneficial owners.

Holders of Common Stock are entitled to one vote per share on matters to be voted upon by the stockholders and are entitled to receive dividends when and if declared by the Board of Directors. The holders of the Common Stock do not have cumulative voting rights, which means that stockholders entitled to more than half of the voting rights of the Company's outstanding Common Stock can elect all of the Directors and the holders of the remaining shares would not be able to elect any Directors. In the event of liquidation, dissolution or winding up of the Company, the holders of Common Stock are entitled to receive, as a class, pro rata, the assets of the Company available for distribution to stockholders. Holders of Common Stock have no preemptive, subscription, redemption or conversion rights. All outstanding shares of Common Stock are fully paid and nonassessable. The Company's Common Stock is listed on the New York Stock Exchange and Pacific Stock Exchange. The Registrar and Transfer Company, Cranford, New Jersey is the transfer agent and registrar for the Company's Common Stock.

UNDERWRITING

Under the terms and subject to the conditions contained in an Underwriting Agreement dated the date hereof, Morgan Stanley & Co. Incorporated (the "Underwriter") has agreed to purchase, and the Company has agreed to sell to the Underwriter, \$40,000,000 principal amount of Debentures.

The Underwriting Agreement provides that the obligation of the Underwriter to pay for and accept delivery of the Debentures is subject to the approval of certain legal matters by counsel and to certain other conditions, including the conditions that no stop order suspending the effectiveness of the Registration Statement is in effect and no proceedings for such purpose are pending before or threatened by the Securities and Exchange Commission and that there has been no material adverse change in the condition of the Company and its subsidiaries, taken as a whole, from that set forth in the Registration Statement. The Underwriter is obligated to take and pay for all of the Debentures offered hereby if any are taken.

The Underwriter proposes to offer part of the Debentures directly to the public at the public offering price set forth on the cover page hereof and part to certain dealers at a price which represents a concession not in excess of 1.35% of the principal amount of the Debentures. The Underwriter may allow, and such dealers may reallow, a concession not in excess of .25% of the principal amount of the Debentures to certain other dealers.

The Company and the Underwriter have agreed to indemnify each other against certain liabilities, including liabilities under the Securities Act of 1933.

The Company has agreed not to offer, sell, contract to sell or otherwise dispose of any shares of Common Stock or any securities convertible into Common Stock for a period of 90 days after the date of this Prospectus, without the prior written consent of Morgan Stanley & Co. Incorporated, other than shares of Common Stock to be issued (i) to or for the benefit of employees or directors, (ii) upon the exercise of options granted under the Company's existing stock option and employee stock purchase plans, (iii) upon conversion of the Debentures or (iv) in connection with acquisitions in which the shares so issued will not be directly or indirectly offered to the public during such 90 day period.

LEGAL OPINIONS

The validity of the Debentures offered hereby and the Common Stock issuable upon conversion will be passed upon for the Company by Greenberg, Margolis, Ziegler, Schwartz, Dratch & Fishman, A Professional Corporation, 3 ADP Boulevard, Roseland, New Jersey 07068 and for the Underwriter by Davis Polk & Wardwell, 1 Chase Manhattan Plaza, New York, New York 10005.

EXPERTS

The financial statements included in this Prospectus and elsewhere in the Registration Statement, to the extent and for the periods indicated in their report, have been examined by Coopers & Lybrand, independent public accountants, and are included herein in reliance upon the authority of said firm as experts in accounting and auditing.

ADDITIONAL INFORMATION

The Company has filed with the Securities and Exchange Commission in Washington, D.C. a Registration Statement under the Securities Act of 1933, as amended, with respect to the securities offered by this Prospectus. This prospectus does not contain all the information set forth in the Registration Statement. For further information with respect to the Company and such securities, reference is made to the Registration Statement and to the Exhibits and Schedules filed therewith. The Registration Statement may be inspected by anyone without charge at the principal office of the Commission in Washington, D.C. and copies of all or any part of it may be obtained from the Commission upon payment of prescribed fees.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	<u>Page</u>
Report of Independent Certified Public Accountants	F-1
Consolidated Statements of Income for the years ended December 31, 1985, 1984 and 1983 .	F-2
Consolidated Balance Sheets at December 31, 1985 and 1984	F-3
Consolidated Statements of Changes in Cash Position for the years ended December 31, 1985, 1984 and 1983	F-4
Consolidated Statements of Stockholders' Equity for the years ended December 31, 1985, 1984 and 1983	F-5
Notes to the Consolidated Financial Statements	F-6

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Stockholders and Board of Directors
of AGS Computers, Inc.:

We have examined the consolidated balance sheets of AGS Computers, Inc. and Subsidiaries as of December 31, 1985 and 1984, and the related consolidated statements of income, stockholders' equity and changes in cash position for the years ended December 31, 1985, 1984 and 1983. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the consolidated financial position of AGS Computers, Inc. and Subsidiaries at December 31, 1985 and 1984 and the consolidated results of their operations and changes in their cash position for the years ended December 31, 1985, 1984 and 1983, in conformity with generally accepted accounting principles applied on a consistent basis.

COOPERS & LYBRAND

Newark, New Jersey
February 21, 1986

AGS COMPUTERS, INC. AND SUBSIDIARIES
Consolidated Statements of Income

	For the years ended December 31,		
	1985	1984	1983
SALES:			
Software	\$117,375,000	\$ 97,177,000	\$ 53,773,000
Microcomputer distribution	161,496,000	124,055,000	91,515,000
Interest income	311,000	399,000	623,000
	<u>279,182,000</u>	<u>221,631,000</u>	<u>145,911,000</u>
COST OF SALES:			
Software	77,710,000	64,382,000	31,937,000
Microcomputer distribution	138,941,000	106,429,000	78,008,000
	<u>216,651,000</u>	<u>170,811,000</u>	<u>109,945,000</u>
Selling, general and administrative expenses	45,103,000	34,593,000	24,133,000
Interest expense	2,300,000	2,832,000	983,000
	<u>264,054,000</u>	<u>208,236,000</u>	<u>135,061,000</u>
Income from continuing operations before income taxes	15,128,000	13,395,000	10,850,000
Income taxes	7,635,000	6,614,000	5,065,000
Income from continuing operations	<u>7,493,000</u>	<u>6,781,000</u>	<u>5,785,000</u>
DISCONTINUED OPERATIONS:			
Loss from discontinued operations (less applicable income taxes of \$417,000)		(483,000)	
Loss on disposal of discontinued operations (less applicable income taxes of \$391,000)		(459,000)	
Loss from discontinued operations		<u>(942,000)</u>	
Net income	<u>\$ 7,493,000</u>	<u>\$ 5,839,000</u>	<u>\$ 5,785,000</u>
INCOME PER SHARE FROM CONTINUING OPERATIONS:			
Primary	\$ 1.43	\$ 1.29	\$ 1.25
Fully diluted	\$ 1.43	\$ 1.29	\$ 1.20
(LOSS) PER SHARE FROM DISCONTINUED OPERATIONS:			
Primary		\$ (0.18)	
NET INCOME PER SHARE:			
Primary	\$ 1.43	\$ 1.11	\$ 1.25
Fully diluted	<u>\$ 1.43</u>	<u>\$ 1.11</u>	<u>\$ 1.20</u>
Weighted average shares outstanding:			
Primary	5,253,000	5,270,000	4,609,000
Fully diluted	<u>5,253,000</u>	<u>5,270,000</u>	<u>5,072,000</u>

See accompanying notes to consolidated financial statements.

AGS COMPUTERS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

	<u>December 31,</u>	
	<u>1985</u>	<u>1984</u>
A S S E T S		
CURRENT ASSETS:		
Cash and temporary investments	\$ 2,969,000	\$ 2,797,000
Accounts receivable-trade, less allowances of \$1,010,000 and \$720,000	37,150,000	26,722,000
Inventories	20,060,000	14,759,000
Prepaid expenses and other assets	5,254,000	3,721,000
Total current assets	65,433,000	47,999,000
Fixed assets	6,417,000	3,990,000
Software products	7,239,000	6,100,000
Costs in excess of net assets of subsidiaries acquired	30,971,000	28,631,000
Other assets	1,041,000	6,539,000
	<u>\$111,101,000</u>	<u>\$ 93,259,000</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Notes payable	\$ 43,000	\$ 1,305,000
Current maturities of long-term debt	4,139,000	3,066,000
Accounts payable and accrued liabilities	25,316,000	18,812,000
Deferred income	3,310,000	2,375,000
Income taxes payable	302,000	203,000
Deferred income taxes payable	10,949,000	8,544,000
Total current liabilities	44,059,000	34,305,000
Deferred income taxes	2,636,000	1,716,000
Long-term debt, less current maturities	15,283,000	14,822,000
Other liabilities	121,000	399,000
Total liabilities	62,099,000	51,242,000
STOCKHOLDERS' EQUITY:		
Common stock, par value \$.10 per share; authorized 25,000,000 shares in 1985 and 1984; issued 5,311,000 and 5,283,000	531,000	528,000
Paid-in capital	23,347,000	23,018,000
Retained earnings	25,964,000	18,471,000
	49,842,000	42,017,000
Less 54,000 shares of treasury stock, at cost	840,000	
Total stockholders' equity	49,002,000	42,017,000
	<u>\$111,101,000</u>	<u>\$ 93,259,000</u>

14100
2066
17282
1300
19193

10949
7636
2583

834
1716
9260

320

See accompanying notes to consolidated financial statements.

AGS COMPUTERS, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Cash Position

	For the years ended December 31,		
	1985	1984	1983
SOURCES OF CASH:			
From continuing operations:			
Income	\$ 7,493,000	\$ 6,781,000	\$ 5,785,000
Equity in losses of affiliated companies	338,000	365,000	
Depreciation and amortization	2,420,000	1,912,000	1,322,000
Changes in balance sheet accounts:			
Income taxes payable-net	2,320,000	4,731,000	1,844,000
Accounts receivable	(9,004,000)	(1,509,000)	(7,367,000)
Prepaid expenses	(765,000)	(167,000)	(881,000)
Accounts payable and accrued expenses	5,875,000	3,201,000	1,886,000
Deferred income	637,000	720,000	(1,416,000)
	9,314,000	16,034,000	1,173,000
From discontinued operations:			
(Loss)		(942,000)	
Depreciation and amortization		18,000	
Changes in balance sheet accounts:			
Income taxes payable-net		(808,000)	
Prepaid expenses		(292,000)	
		(2,024,000)	
Total from operations	9,314,000	14,010,000	1,173,000
Sale of common stock			8,094,000
Common stock issued on conversion of debentures ..			8,672,000
Common stock issued upon acquisition of subsidiaries and equity interests		584,000	2,492,000
Common stock issued under employee stock ownership and stock purchase plans	327,000	152,000	
Stock options exercised	135,000	92,000	120,000
Tax benefit from the issuance of stock options		128,000	
Increase in long-term debt	4,500,000	20,000,000	12,000
Decrease (increase) in other assets	1,175,000	(1,248,000)	(82,000)
Total sources of cash	15,451,000	33,718,000	20,481,000
USES OF CASH:			
Acquisition of subsidiaries and equity interests	349,000	18,362,000	8,387,000
Decrease (increase) in notes payable	1,932,000	10,621,000	(2,770,000)
Payment of long-term debt	3,173,000	2,527,000	9,708,000
Additions to fixed assets, net	3,607,000	1,615,000	1,331,000
Increase in inventories	5,301,000	1,111,000	4,697,000
Additions to software products-net	289,000	638,000	1,569,000
Decrease in other liabilities	100,000	360,000	130,000
Purchase of treasury stock	528,000		
Total uses of cash	15,279,000	35,234,000	23,052,000
Increase (decrease) in cash and temporary investments	\$ 172,000	\$ (1,516,000)	\$ (2,571,000)

See accompanying notes to consolidated financial statements.

AGS COMPUTERS, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity
For the years ended December 31, 1983, 1984, and 1985

	Common Stock		Paid-in Capital	Retained Earnings	Treasury Stock	
	Shares	Amount			Shares	Cost
Balance, December 31, 1982	3,646,000	\$364,000	\$ 2,848,000	\$ 6,847,000	690	
Net income				5,785,000		
Common stock sold	575,000	58,000	8,036,000			
Common stock issued	127,000	13,000	2,479,000			
Stock options exercised	19,000	2,000	118,000		(690)	
Common stock issued upon conversion of debentures	855,000	85,000	8,587,000			
Balance, December 31, 1983	5,222,000	522,000	22,068,000	12,632,000		
Net income				5,839,000		
Common stock issued	39,000	4,000	580,000			
Stock options exercised	13,000	1,000	91,000			
Common stock issued under employee ownership plan	6,000	1,000	123,000			
Common stock issued under employee stock purchase plan	3,000		28,000			
Tax benefit from the issuance of stock options			128,000			
Balance, December 31, 1984	5,283,000	528,000	23,018,000	18,471,000		
Net income				7,493,000		
Treasury stock acquired					62,000	\$970,000
Stock options exercised	15,000	2,000	133,000			
Common stock issued under employee ownership plan	13,000	1,000	198,000			
Common stock issued under employee stock purchase plan			(2,000)		(8,000)	(130,000)
Balance, December 31, 1985	<u>5,311,000</u>	<u>\$531,000</u>	<u>\$23,347,000</u>	<u>\$25,964,000</u>	<u>54,000</u>	<u>\$840,000</u>

See accompanying notes to consolidated financial statements.

AGS COMPUTERS, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Cash Position

	For the years ended December 31,		
	1985	1984	1983
SOURCES OF CASH:			
From continuing operations:			
Income	\$ 7,493,000	\$ 6,781,000	\$ 5,785,000
Equity in losses of affiliated companies	338,000	365,000	
Depreciation and amortization	2,420,000	1,912,000	1,322,000
Changes in balance sheet accounts:			
Income taxes payable-net	2,320,000	4,731,000	1,844,000
Accounts receivable	(9,004,000)	(1,509,000)	(7,367,000)
Prepaid expenses	(765,000)	(167,000)	(881,000)
Accounts payable and accrued expenses	5,875,000	3,201,000	1,886,000
Deferred income	637,000	720,000	(1,416,000)
	9,314,000	16,034,000	1,173,000
From discontinued operations:			
(Loss)		(942,000)	
Depreciation and amortization		18,000	
Changes in balance sheet accounts:			
Income taxes payable-net		(808,000)	
Prepaid expenses		(292,000)	
		(2,024,000)	
Total from operations	9,314,000	14,010,000	1,173,000
Sale of common stock			8,094,000
Common stock issued on conversion of debentures			8,672,000
Common stock issued upon acquisition of subsidiaries and equity interests		584,000	2,492,000
Common stock issued under employee stock ownership and stock purchase plans	327,000	152,000	
Stock options exercised	135,000	92,000	120,000
Tax benefit from the issuance of stock options		128,000	
Increase in long-term debt	4,500,000	20,000,000	12,000
Decrease (increase) in other assets	1,175,000	(1,248,000)	(82,000)
Total sources of cash	15,451,000	33,718,000	20,481,000
USES OF CASH:			
Acquisition of subsidiaries and equity interests	349,000	18,362,000	8,387,000
Decrease (increase) in notes payable	1,932,000	10,621,000	(2,770,000)
Payment of long-term debt	3,173,000	2,527,000	9,708,000
Additions to fixed assets, net	3,607,000	1,615,000	1,331,000
Increase in inventories	5,301,000	1,111,000	4,697,000
Additions to software products-net	289,000	638,000	1,569,000
Decrease in other liabilities	100,000	360,000	130,000
Purchase of treasury stock	528,000		
Total uses of cash	15,279,000	35,234,000	23,052,000
Increase (decrease) in cash and temporary investments	\$ 172,000	\$ (1,516,000)	\$ (2,571,000)

See accompanying notes to consolidated financial statements.

AGS COMPUTERS, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity
For the years ended December 31, 1983, 1984, and 1985

	Common Stock		Paid-in Capital	Retained Earnings	Treasury Stock	
	Shares	Amount			Shares	Cost
Balance, December 31, 1982	3,646,000	\$364,000	\$ 2,848,000	\$ 6,847,000	690	
Net income				5,785,000		
Common stock sold	575,000	58,000	8,036,000			
Common stock issued	127,000	13,000	2,479,000			
Stock options exercised	19,000	2,000	118,000		(690)	
Common stock issued upon conversion of debentures	<u>855,000</u>	<u>85,000</u>	<u>8,587,000</u>			
Balance, December 31, 1983	5,222,000	522,000	22,068,000	12,632,000		
Net income				5,839,000		
Common stock issued	39,000	4,000	580,000			
Stock options exercised	13,000	1,000	91,000			
Common stock issued under employee ownership plan	6,000	1,000	123,000			
Common stock issued under employee stock purchase plan	3,000		28,000			
Tax benefit from the issuance of stock options			<u>128,000</u>			
Balance, December 31, 1984	5,283,000	528,000	23,018,000	18,471,000		
Net income				7,493,000		
Treasury stock acquired					62,000	\$970,000
Stock options exercised	15,000	2,000	133,000			
Common stock issued under employee ownership plan	13,000	1,000	198,000			
Common stock issued under employee stock purchase plan			<u>(2,000)</u>		<u>(8,000)</u>	<u>(130,000)</u>
Balance, December 31, 1985	<u>5,311,000</u>	<u>\$531,000</u>	<u>\$23,347,000</u>	<u>\$25,964,000</u>	<u>54,000</u>	<u>\$840,000</u>

See accompanying notes to consolidated financial statements.

AGS COMPUTERS, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

Note A—*Significant Accounting Policies:*

The financial statements include the accounts of the Company and its wholly-owned subsidiaries, after elimination of all significant intercompany accounts and transactions.

Service revenues arising from time and material contracts are recognized as services are rendered. Revenues from sales of software packages are recognized as follows: (a) on sales made on standard terms, 90% of the sale amount is recognized when the package is in deliverable form with the balance recognized upon completion of training and support; (b) on sales made subject to client acceptance of the package, revenues are recognized after acceptance is received for the package and the collateral training and support. Revenues from maintenance contracts are recognized ratably over the term of each contract. Microcomputer sales, costs of microcomputer sales and related selling expenses are recorded when delivery is made to the customer.

Fixed assets are recorded at cost. Depreciation is computed principally on the straight line method based on estimated useful lives. Leasehold improvements are amortized over the life of the lease, or their estimated useful lives, whichever is shorter.

Costs in excess of net assets acquired are being amortized over forty-year periods. Accumulated amortization aggregated \$2,058,000 and \$1,206,000 at December 31, 1985 and 1984, respectively.

Inventories, consisting of microcomputer systems, peripherals and computer accessories, are stated at the lower of cost or market; cost is determined by the first-in first-out (FIFO) method.

Deferred income taxes result from reporting certain revenue and expense items differently for financial and tax reporting and are shown primarily as current liabilities although not payable within one year of their respective year-end dates. Investment and research and development tax credits are reflected as a reduction of federal income taxes in the year realized.

Research and development costs which are charged to operations, amounted to \$5,174,000 (1985), \$4,413,000 (1984) and \$2,753,000 (1983).

In December 1985, the Company adopted as of January 1, 1985 the capitalization and amortization of software cost provisions of FASB 86. Costs of new products and enhancements to existing products are capitalized when technological feasibility exists and are amortized over the greater of the ratio of the product's current-to-future revenue stream or the straight line method over its estimated useful life which generally approximates five years. Costs deferred and amortized were \$2,579,000 and \$2,291,000 for 1985, respectively. The change had an immaterial effect on the results of operations. Costs of software product enhancements with an established market deferred and amortized were \$2,055,000 and \$2,230,000 and \$666,000 and \$198,000 for the years 1984 and 1983, respectively.

Software products at December 31, 1985 include \$4,608,000 arising from the purchase of subsidiaries and are stated net of accumulated amortization of \$2,191,000.

Primary net income per share is based on the weighted average number of shares of common stock outstanding. Dilution resulting from stock options outstanding is not significant. Fully diluted net income per share assumed conversion on January 1, 1983 of all convertible debentures into common stock; for this calculation net income was increased by the after tax interest of the debentures.

AGS COMPUTERS, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements—(Continued)

Note B—Fixed Assets:

	December 31,	
	1985	1984
Fixed assets consist of:		
Furniture and equipment	\$ 5,252,000	\$ 3,976,000
Computer equipment	3,847,000	1,814,000
Leasehold improvements	1,357,000	913,000
	10,456,000	6,703,000
Less: accumulated depreciation and amortization	4,039,000	2,713,000
	\$ 6,417,000	\$ 3,990,000

Note C—Notes Payable:

Notes payable at December 31, 1984 are owed to former stockholders of companies acquired.

There were no short-term borrowings outstanding in 1985. Short-term borrowings averaged (on a month-end basis) \$1,033,000 (1984) and \$2,106,000 (1983) at a monthly weighted average interest rate of 11.0% and 10.8%, respectively. The maximum amount of short-term borrowings at any month-end was \$12,400,000 (1984) and \$5,200,000 (1983).

Note D—Long-Term Debt:

	December 31,	
	1985	1984
Long-term debt consists of the following:		
Bank term note	\$ 9,750,000	\$12,750,000
Bank revolving credit note	8,500,000	4,000,000
Other	1,172,000	1,138,000
	19,422,000	17,888,000
Less, current maturities	4,139,000	3,066,000
	\$15,283,000	\$14,822,000

The Company's bank credit facility aggregated \$24,750,000 at December 31, 1985 of which \$9,750,000 was under the term note and \$15,000,000 under the revolving credit note. The term note requires quarterly installments of principal of \$750,000 to maturity at January 31, 1989 plus interest at prime. The revolving credit note terminates on October 31, 1986, at which date all amounts then outstanding are converted to a Funded Term Loan payable in quarterly installments commencing on January 31, 1987 with a final maturity date of October 31, 1989; interest, at the Company's choosing, is either at prime or LIBOR (plus 1¼% and other adjustments) to October 31, 1986 and ½% over prime and 1¾% over LIBOR thereafter. Under this credit facility the payment of cash dividends is prohibited and requires the Company to maintain several financial ratios, including working capital and cash flow. The agreement also requires the Company to maintain a compensating cash balance of \$500,000.

AGS COMPUTERS, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)

Maturities of the non-current portion of long-term debt at December 31, 1985 are as follows:

1987	\$ 5,866,000
1988	5,834,000
1989	<u>3,583,000</u>
	<u>\$15,283,000</u>

Note E—Income Taxes:

The provisions for income taxes consist of the following:

	Years ended December 31,		
	<u>1985</u>	<u>1984</u>	<u>1983</u>
From continuing operations:			
Currently payable:			
Federal	\$2,461,000	\$ 493,000	\$1,731,000
State and local	<u>1,115,000</u>	<u>583,000</u>	<u>780,000</u>
	<u>3,576,000</u>	<u>1,076,000</u>	<u>2,511,000</u>
Deferred:			
Federal	3,571,000	4,742,000	2,228,000
State and local	<u>488,000</u>	<u>796,000</u>	<u>326,000</u>
	<u>4,059,000</u>	<u>5,538,000</u>	<u>2,554,000</u>
	<u>\$7,635,000</u>	<u>\$6,614,000</u>	<u>\$5,065,000</u>
From discontinued operations:			
Currently payable federal		\$ (417,000)	
Deferred federal		<u>(391,000)</u>	
		<u>\$ (808,000)</u>	

The effect on deferred taxes from (i) reporting of income on the cash basis for income tax purposes was \$1,731,000, \$1,196,000 and \$1,662,000 for 1985, 1984 and 1983, respectively, (ii) the expensing of software product enhancements for income tax purposes was \$501,000 in 1985 and \$659,000 in 1984, and (iii) differences in the valuation and amortization of acquired subsidiary assets was \$1,001,000 in 1985 and \$802,000 in 1984.

AGS COMPUTERS, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)

A reconciliation of the provisions for taxes on income from continuing operations at the applicable Federal statutory income tax rate to the tax provisions as reported is as follows:

	<u>Years ended December 31,</u>		
	<u>1985</u>	<u>1984</u>	<u>1983</u>
Provision computed at the Federal statutory income tax rate	\$6,959,000	\$6,162,000	\$4,968,000
State and local income taxes, net of federal tax benefit...	829,000	732,000	597,000
Amortization of costs in excess of net assets acquired ...	376,000	326,000	
Research and development credit	(155,000)	(510,000)	(320,000)
Investment tax credit	(246,000)	(136,000)	(356,000)
Other	<u>(128,000)</u>	<u>40,000</u>	<u>176,000</u>
As reported	<u>\$7,635,000</u>	<u>\$6,614,000</u>	<u>\$5,065,000</u>

Note F—Accounts Payable and Accrued Liabilities:

	<u>December 31,</u>	
	<u>1985</u>	<u>1984</u>
Accounts payable and accrued liabilities consist of:		
Accounts payable to vendors	\$20,220,000	\$13,934,000
Accrued payroll, vacation and bonus expenses	3,010,000	2,164,000
Other	<u>2,086,000</u>	<u>2,714,000</u>
	<u>\$25,316,000</u>	<u>\$18,812,000</u>

Note G—Stock Plans:

During 1984, the Company increased the maximum number of options under its incentive stock option plan (“ISOP”) from 250,000 shares to 500,000 shares. The options may be granted at not less than the market price of the shares at date of grant and are generally exercisable over a 10 year period. At December 31, 1985 options for 282,865 shares were outstanding under the ISOP.

At December 31, 1985 options for 1,500 shares remain outstanding under the Company’s terminated qualified stock option plan.

Certain information with respect to options granted under the above noted plans are as follows:

	<u>Number of Shares</u>		
	<u>Years ended December 31,</u>		
	<u>1985</u>	<u>1984</u>	<u>1983</u>
Shares under option at beginning of period (\$.53-\$28.75 a share) .	235,615	184,265	123,430
Granted (\$11.50-\$28.75).....	129,634	81,450	106,446
Exercised (\$.53-\$20.00)	(14,567)	(13,047)	(19,847)
Cancelled (\$9.75-\$26.50)	<u>(66,317)</u>	<u>(17,053)</u>	<u>(25,764)</u>
Shares under option at end of period (\$.53-\$28.75 a share)	<u>284,365</u>	<u>235,615</u>	<u>184,265</u>

At December 31, 1985 and 1984 options for 99,312 and 74,416 shares, respectively, were exercisable.

AGS COMPUTERS, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)

No charges were made to income in connection with the aforementioned stock option plans since all options granted were at market.

During 1983, the Company adopted an employee stock purchase plan (ESPP) which authorizes the granting of 250,000 shares of stock to all full-time employees of the Company and its subsidiaries at a price not less than 85% of the market value at date of grant. Options to purchase 50,000 shares under this plan were authorized of which 3,007 were issued in 1984 at \$14.25 per share and 8,336 were issued in 1985 at \$15.30 per share. No shares were issuable under this plan at December 31, 1985.

During 1983, the Company adopted an employee stock ownership purchase plan under which all qualified employees of the Company and its subsidiaries are granted shares of stock equal in value to .5% of their annual compensation. In connection with this plan, expenses of \$291,000, \$223,000 and \$134,000 were reflected in the statements of income for the years ended December 31, 1985, 1984 and 1983, respectively.

Note H—Commitments:

The Company is obligated under operating lease agreements, for its offices, warehouse facilities, and equipment. A number of leases require that the Company pay additional rents due to increased operating costs to the lessor. The minimum aggregate rentals payable under all operating leases at December 31, 1985 are as follows:

1986		\$ 3,716,000
1987		3,398,000
1988		2,891,000
1989		1,862,000
1990		958,000
1991 and beyond		<u>3,567,000</u>
		<u>\$16,392,000</u>

Total rental expense charged to income was \$4,244,000 (1985), \$2,961,000 (1984) and \$1,760,000 (1983).

Note I—Profit Sharing and 401K Investment Plan:

The Company has profit sharing plans covering substantially all employees of the parent and certain of its subsidiaries. The annual contributions under the plans are determined by the Board of Directors. Profit sharing contributions are funded as accrued. In 1985, the Company and some subsidiaries amended their profit sharing plans to become a 401K employee investment plan. The Company and subsidiaries match employee contributions in varying amounts. The contributions under all plans amounted to \$327,000 (1985), \$218,000 (1984) and \$198,000 (1983).

Note J—Litigation:

Management and legal counsel are of the opinion that pending litigation will not have a material adverse effect on the financial position of the Company.

Note K—Businesses Acquired:

In 1983 the Company increased its investment in Micro Distributors, Inc., a distributor of microcomputers, from 67% to 100% by purchasing for 123,000 shares of Common Stock (market value \$2,381,000) the interests of minority shareholders.

AGS COMPUTERS, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)

In March 1983, the Company purchased Microamerica Distributing Co., Inc. which is an independent distributor of microcomputers, peripherals, and accessories for \$5,557,000.

In June 1983, the Company purchased for \$7,179,000 (of which \$3,915,000 was paid in 1984) DISC, Inc., which designs proprietary software products. The purchase agreement calls for additional payments if pre-tax income, as defined, exceeds certain minimum amounts during the three year period following acquisition; under this aspect of the agreement an additional \$122,000, \$38,000 and \$589,000 was accrued at December 31, 1985, 1984 and 1983, respectively.

In January 1984 the Company acquired Software Design Associates, Inc. (SDA), a software services company, for approximately \$12,900,000.

In December 1984 the Company acquired for \$3,450,000 (of which \$1,000,000 was paid on December 24, 1985 and \$1,000,000 is payable on December 24, 1986) Systems Strategies Inc. which provides computer services and develops software products. The purchase agreement calls for additional payments, if pre-tax income, as defined, exceeds certain minimum amounts. The acquisition was effective January 1, 1985 and accordingly no operations were reflected in the Statement of Income for 1984, and the purchase price was shown on the balance sheet in other assets.

These acquisitions have been accounted for as purchases; accordingly, results of operations of the acquired companies are included in the accompanying financial statements since their respective dates of acquisition. The excess of purchase price over net assets of businesses acquired at dates of acquisition approximates \$28,850,000 and is being amortized over forty-year periods.

The unaudited pro forma consolidated results of operations of the Company as if Micro Distributors, Inc., Microamerica Distributing Company, Inc., DISC, Inc. and SDA had been acquired on January 1, 1983 are as follows:

	Year ended December 31, <u>1983</u>
Sales	\$175,664,000
Cost of sales	130,727,000
Selling, general and administrative expenses	34,375,000
Income taxes	5,059,000
Net income	5,503,000
Net income per share	
Primary	1.19
Fully diluted	<u>\$ 1.14</u>

The results of operations for 1984 would not have been materially affected if Systems Strategies, Inc. had been acquired on January 1, 1984.

Note L—Discontinued Operations:

Effective December 31, 1984, the Company adopted a plan to discontinue its subsidiary which wholesaled microcomputer software manufactured and packaged by outside vendors. At December 31, 1984, the net assets of the discontinued operation, consisting principally of inventory, trade receivables and fixed assets were stated at estimated realizable values and reclassified to prepaid expenses and other assets.

AGS COMPUTERS, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)

Sales of the discontinued operation were approximately \$4,100,000 in 1984. This subsidiary commenced business in late 1983 and did not have a material effect on 1983 operations. In February 1985, the Company exchanged the net assets of the subsidiary for \$442,000 of AGS common stock held by management of the discontinued operation. The loss on disposal before tax benefits includes operating losses of approximately \$150,000 incurred prior to the disposal date.

Note M—Quarterly Financial Information:

Unaudited quarterly financial data for the years 1985 and 1984 is as follows:

	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
1985				
Sales	\$65,742,000	\$70,327,000	\$67,617,000	\$75,496,000
Gross profit	14,738,000	16,105,000	15,420,000	16,268,000
Net income	1,925,000	1,734,000	1,854,000	1,980,000
Net income per share	<u>\$.37</u>	<u>\$.33</u>	<u>\$.35</u>	<u>\$.38</u>
1984				
Sales	\$52,658,000	\$52,177,000	\$54,836,000	\$61,960,000
Gross profit	11,794,000	12,255,000	13,188,000	13,584,000
Income from Continuing Operations	1,727,000	1,428,000	1,860,000	1,766,000
Loss from Discontinued Operations	(168,000)	(121,000)	(82,000)	(112,000)
Loss on Disposal of Discontinued Operations				(459,000)
Net income	1,559,000	1,307,000	1,778,000	1,195,000
Income Per Share from Continuing Operations .....	.33	.27	.36	.34
Loss Per Share from Discontinued Operations	(.03)	(.02)	(.02)	(.11)
Net income per share	<u>\$.30</u>	<u>\$.25</u>	<u>\$.34</u>	<u>\$.23</u>

AGS COMPUTERS, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements—(Continued)

Note N—Company Operations:

Information about the Company's operations (principally from domestic operations) is as follows:

	<u>Software</u>	<u>Microcomputer Distribution</u>	<u>Consolidated</u>
YEAR ENDED DECEMBER 31, 1985:			
Sales	\$ 117,375,000	\$ 161,496,000	\$ 278,871,000
Operating profit	<u>\$ 13,192,000</u>	<u>\$ 7,679,000</u>	\$ 20,871,000
General and corporate expenses			(3,754,000)
Interest income			311,000
Interest expense			(2,300,000)
Income before income taxes			<u>\$ 15,128,000</u>
IDENTIFIABLE ASSETS:			
Operations	\$ 62,542,000	\$ 45,087,000	\$ 107,629,000
Corporate (principally temporary investments)			3,472,000
Total			<u>\$ 111,101,000</u>
Additions to fixed assets	\$ 1,105,000	\$ 2,502,000	\$ 3,607,000
Depreciation and amortization of fixed assets	<u>\$ 1,120,000</u>	<u>\$ 482,000</u>	<u>\$ 1,602,000</u>
YEAR ENDED DECEMBER 31, 1984:			
Sales	\$ 97,177,000	\$ 124,055,000	\$ 221,232,000
Operating profit	<u>\$ 13,078,000</u>	<u>\$ 5,411,000</u>	\$ 18,489,000
General and corporate expenses			(2,661,000)
Interest income			399,000
Interest expense			(2,832,000)
Income before income taxes			<u>\$ 13,395,000</u>
IDENTIFIABLE ASSETS:			
Operations	\$ 57,172,000	\$ 33,265,000	\$ 90,437,000
Corporate (principally temporary investments)			2,822,000
Total			<u>\$ 93,259,000</u>
Additions to fixed assets	\$ 1,362,000	\$ 253,000	\$ 1,615,000
Depreciation and amortization of fixed assets	<u>\$ 924,000</u>	<u>\$ 275,000</u>	<u>\$ 1,199,000</u>
YEAR ENDED DECEMBER 31, 1983:			
Sales	\$ 53,773,000	\$ 91,515,000	\$ 145,288,000
Operating profit	<u>\$ 9,733,000</u>	<u>\$ 2,714,000</u>	\$ 12,447,000
General and corporate expenses			(1,237,000)
Interest income			623,000
Interest expense			(983,000)
Income before income taxes			<u>\$ 10,850,000</u>
IDENTIFIABLE ASSETS:			
Operations	\$ 32,737,000	\$ 33,617,000	\$ 66,354,000
Corporate (principally temporary investments)			2,499,000
Total			<u>\$ 68,853,000</u>
Additions to fixed assets	\$ 562,000	\$ 769,000	\$ 1,331,000
Depreciation and amortization of fixed assets	<u>\$ 622,000</u>	<u>\$ 353,000</u>	<u>\$ 975,000</u>

AGS COMPUTERS, INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Concluded)

The Company operates in two industries: Software and the distribution of microcomputers and other products.

Sales to a group of customers under common control were \$29,194,000 and \$188,000 (1985), \$27,087,000 and \$504,000 (1984) and \$14,909,000 and \$179,000 (1983) of the sales of the software and microcomputer segments, respectively.

Note O—*Subsequent Events:*

In January 1986, the Company acquired effective control of Compuserve, a Canadian distributor of microcomputer products. The acquisition of the business for \$5,000,000 is subject to the consent of a Canadian government agency and is expected to be completed during the first quarter of 1986. The unaudited pro forma consolidated sales and net income of the Company as if Compuserve had been acquired on January 1, 1985 would have been \$309,452,000 and \$7,668,000, respectively.

Subsequent to December 31, 1985, the Company amended its bank credit facility to \$35,000,000 of which \$15,000,000 is under a five year term note requiring quarterly installments of \$750,000 and \$20,000,000 under a revolving credit note which terminates January 31, 1988 and becomes a three year term loan requiring equal quarterly installments thereafter. Interest terms and loan covenants under the amended agreement are substantially the same as the existing facility.

AGS